

## Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 FS-01 ABF-01 EB-08 SSO-00 NSCE-00  
USIE-00 INRE-00 AID-05 CIAE-00 COME-00 FRB-03 INR-07  
NSAE-00 TRSE-00 XMB-02 OPIC-03 SP-02 LAB-04 SIL-01  
OMB-01 NSC-05 SS-15 STR-04 CEA-01 L-03 DODE-00 PA-01  
PRS-01 AGRE-00 FEA-01 INT-05 H-01 /086 W  
-----150119Z 031396 /70/46

O 141200Z MAR 77  
FM AMEMBASSY COLOMBO  
TO SECSTATE WASHDC IMMEDIATE 6898  
INFO AMEMBASSY NEW DELHI IMMEDIATE

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C O R R E C T E D C O P Y - (TO READ SECTION 1 OF 2)

E.O. 11652: N/A

TAGS: EFIN, CE  
SUBJECT: SRI LANKA REVALUES RUPEE

NEW DELHI FOR FINATT

REF: COLOMBO 0878

1. SUMMARY: (BEGIN LIMITED OFFICIAL USE) TO STUNNED SURPRISE OF SRI LANKA'S FINANCIAL AND DIPLOMATIC COMMUNITY, RUPEE REVALUED BY 20 PERCENT ON MARCH 12. PRESS STATEMENT BY FINANCE MINISTER BANDARANAIKE SAID MOVE WAS TAKEN AS RESULT OF CURRENT BOOM IN WORLD MARKETS FOR SRI LANKA'S EXPORTS, AND LOWER COST OF IMPORTS RESULTING FROM REVALUATION WILL BE PASSED ON TO CONSUMERS. MINISTER PREDICTED NO ADVERSE EFFECTS ON EXPORTS OR TOURISM. EMBASSY UNDERSTANDS MONETARY BOARD OBJECTION TO REVALUATION WAS OVERRIDDEN BY PRIME MINISTER, AND FINANCE SECRETARY (WHO IS PRESIDENT OF BOARD) MAY BE OUT OF A JOB. DESPITE MINISTER'S ASSURANCES, EMBASSY BELIEVES REVALUATION  
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WILL RESULT IN DETERIORATION OF BALANCE OF PAYMENTS AND NATIONAL INCOME WITH CONSEQUENT RISE IN UNEMPLOYMENT. EMBASSY WOULD APPRECIATE ANY INFORMATION DEPARTMENT MAY RECEIVE REGARDING REACTION OF AID DONORS AND COMMERCIAL CREDITORS. (END LIMITED OFFICIAL USE) END SUMMARY.  
2. (BEGIN UNCLASSIFIED) EFFECTIVE MARCH 12, OFFICIAL PARITY OF SRI LANKA RUPEE WITH RESPECT TO US DOLLAR WAS

REVALUED (OR APPRECIATED, IF YOU PREFER) FROM RS. 8.7154 TO RS. 7.2817. THIS REPRESENTS 19.7 PERCENT INCREASE IN DOLLAR VALUE OF RUPEE, OR, AS FINANCE MINISTER FELIX BANDARANAIKE PUT IT IN A RADIO INTERVIEW, DOLLAR WAS DEVALUED BY 16.5 PERCENT IN TERMS OF RUPEES. FOREIGN EXCHANGE ENTITLEMENT CERTIFICATE (FEEC) RATE REMAINS 65 PERCENT OVER THE OFFICIAL RATE.

3. PRESS RELEASE ISSUED BY FINANCE MINISTER AND CARRIED IN MARCH 13 NEWSPAPERS STATED RUPEE HAD "STRENGTHENED" AS A RESULT OF CURRENT "BOOM" IN INTERNATIONAL MARKETS FOR SRI LANKA'S PRIMARY COMMODITIES, AND SAID INTERNATIONAL RESERVES HAD RISEN TO RS. 1,347 MILLION (\$154.5 MILLION) AT END OF JANUARY 1977. MINISTER PREDICTED BOOM WOULD CONTINUE INTO FORESEEABLE FUTURE. HE CITED

INCREASE IN TEA AND RUBBER PRICES SINCE 1970 AND SPAAID GSL WAS REVERESING "FALL IN RUPEE VALUE INITIATED BY UNP GOVT IN NOVEMBER 1967 AND COMPOUNDED IN RECENT YEARS BY WORLD INFLATION." MINISTRY SAID INCREASE IN VALUE OF RUPEE WILL HAVE "EFFECT OF MITIGATING THE IMPACT OF WORLD INFLATION ON OUR ECONOMY," AND "BENEFITS OF REDUCTION IN COST OF IMPORTS" WILL BE PASSED ON TO CONSUMERS. WHILE PRICES OF SUBSIDIZED ITEMS SUCH AS KEROSENE, RICE, FLOUR, AND SUGAR WOULD NOT IMMEDIATELY BE AFFECTED BY REVALUATION, OTHER PRESS STORIES INDICATE GSL ALREADY CONSIDERING REDUCTION OF KEROSENE AND SUGAR PRICES. ON EXPORT SIDE, MINISTER'S STATEMENT SAID "RUPEE VALUE OF SRI LANKA EXPORTS WILL DECLINE CORRESPONDINGLY; BUT IN THE LIGHT OF THE INCREASE IN THE MARGINS AVAILABLE TO EXPORTERS LIMITED OFFICIAL USE

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CONSEQUENT UPON THE BOOM IN COMMODITY PRICES OBTAINING IN THE INTERNATIONAL MARKETS, THERE SHOULD BE NO ADVERSE EFFECTS UPON THE COMPETITIVENESS OF OUR EXPORTS."

4. IN RADIO INTERVIEW EVENING MARCH 12, FINANCE MINISTER SAID GSL WAS UNDER NO "OBLIGATION" TO INTERNATIONAL MONETARY FUND (IMF) AND WAS FREE TO ADJUST RUPEE PARITIES. HE STATED PRESENT GSL WAS TAKING ADVANTAGE OF "NEW FOUND ECONOMIC STRENGTH" WHICH UNP GOVT FAILED TO DO DURING KOREAN WAR BOOM. WHILE ADMITTING THAT SRI LANKA WILL NOW BE 20 PERCENT MORE EXPENSIVE FOR TOURIST, MINISTER BANDARANAIKE DOUBTED REVALUATION WOULD HAVE DETRIMENTAL EFFECT ON TOURISM. HE ALSO ACKNOWLEDGED THAT RUPEE EARNINGS OF GEM EXPORTERS WOULD DROP BUT SAID EXPORTERS HAVE HAD IT "TOO GOOD ." HE SAID REVALUATION WOULD PROVIDE NET GAIN TO GSL BUDGET AND HINTED AT POSSIBLE TAX REDUCTIONS. (END UNCLASSIFIED).

5. (BEGIN LIMITED OFFICIAL USE) EMBASSY UNDERSTANDS THAT

MONETARY BOARD MET FRIDAY, MARCH 11, AND UNANIMOUSLY  
REJECTED FINANCE MINISTER'S PROPOSAL TO REVALUE RUPEE.  
MINISTER THEN HELD EMERGENCY CABINET MEETING AND PER-  
SUADED PRIME MINISTER TO OVERRULE MONETARY BOARD. MARCH  
14 DAILY MIRROR REPORTS THAT FINANCE MINISTER HAS DIRECTED  
THAT ALL FILES AND DOCUMENTS RELATING TO "CERTAIN FISCAL  
AND MONETARY MATTERS" BE SUBMITTED DIRECTLY TO HIM AND  
NOT TO SECRETARY LAL JAYAWARDENA (WHO IS HEAD OF MONETARY  
BOARD). ON MARCH 12, IN EFFORT TO FIND OUT WHAT HAD  
ACTUALLY HAPPENED TO RUPEE PARITY, EMBASSY OFFICER SPOKE  
TWICE WITH JAYAGWARDENA WHO AT FIRST WOULD NOT CONFIRM  
REVALUATION (RETELL AND ONLY LATER IN DAY WOULD HE SAY  
THAT REVALUATION HAD OCCURRED BUT REFUSED FURTHER COMMENT  
OTHER THAN TO REFER EMBOFF TO MINISTER'S STATEMENT WHICH  
APPEARED IN PRESS NEXT DAY. IT WAS QUITE OBVIOUS THAT  
JAYAWARDENA WAS VERY UPSET AND IT NOW APPEARS THAT HIS  
OPPOSITION WAS TOO MUCH FOR MINISTER'S LIKING, AND FINANCE  
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MINISTRY MAY SHORTLY HAVE A NEW SECRETARY.

6. EMBASSY ALSO UNDERSTANDS THAT, DESPITE MINISTER'S  
STATEMENT, ARTICLES OF IMF REQUIRE PRIOR IMF APPROVAL FOR  
MAJOR PARITY CHANGES. IT DOUBTFUL THAT GSL INFORMED IMF  
LET ALONE REQUESTED PERMISSION TO REVALUE.

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ACTION NEA-10

INFO OCT-01 ISO-00 FS-01 ABF-01 EB-08 SSO-00 NSCE-00  
USIE-00 INRE-00 AID-05 CIAE-00 COME-00 FRB-03 INR-07  
NSAE-00 TRSE-00 XMB-02 OPIC-03 SP-02 LAB-04 SIL-01  
OMB-01 NSC-05 SS-15 STR-04 CEA-01 L-03 DODE-00 PA-01  
PRS-01 AGRE-00 FEAE-00 INT-05 NEAE-00 H-01 /085 W  
-----141423Z 023132 /43

O 141200Z MAR 77

FM AMEMBASSY COLOMBO

TO SECSTATE WASHDC IMMEDIATE 6899

INFO AMEMBASSY NEW DELHI IMMEDIATE

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7. THERE ARE NO INDICATIONS THAT ANY STAFF WORK WAS DONE BY CENTRAL BANK OR MINISTRIES OF FINANCE AND ECONOMICS BEFORE DECISION WAS TAKEN TO REVALUE. OFFICIAL IN EXTERNAL RESOURCES DIVISION, WHICH IS OFFICE IN MINISTRY OF PLANNING AND ECONOMIC AFFAIRS RESPONSIBLE FOR PREPARATION OF FOREIGN EXCHANGE BUDGET, SAID THEY NOW DID NOT KNOW WHERE TO START IN REVISING FOREIGN EXCHANGE BUDGET TO TAKE ACCOUNT OF REVALUATION.

8. WHILE IT WILL TAKE SOME TIME BEFORE FULL IMPACT OF REVALUATION KNOWN, IT REASONABLE TO ASSUME THAT SRI LANKA'S POOR BALANCE OF PAYMENTS SIUTATION WILL DETERIORATE FURTHER. WHILE THERE ARE NO STUDIES AVAILABLE ON ELASTICITY OF DEMAND FOR IMPORTS IN SRI LANKA, LOWER DOMESTIC PRICES ARE SURE TO STIMULATE DEMAND. ASSUMING ELASTICITY IS GREATER THAN ONE (RECENT REDUCTIONS IN FLOUR PRICES INDICATED ELASTICITY OF ABOUT 2 FOR THAT COMMODITY) VOLUME OF IMPORTS WOULD INCREASE.AS FINANCE MINISTER'S PURPOSE IN REVALUING IS CYNICAL EFFORT TO MAKE VOTERS HAPPY JUST BEOFRE ELECTIONS, THERE WOULD BE NO POLITICAL BENEFIT FROM LOWER PRICES IF  
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SUPPLY DOES NOT MEET INCREASED DEMAND. AS A CONSEQUENCE, GSL WILL NOW HAVE TO IMPORT GERATER QUANTITIES OF FOOD, TEXTILES, AND OTHER BASIC CONSUMER GOODS OR FACE VOTER RESENTMENT OVER SHORTAGES. CURRENT PROBLEMS IN DISTRI-BUTION OF TEXTILES AND RECENT BREAKDOWN IN DISTRIBUTION OF FLOUR INDICATES GSL MAY HAVE DIFFICULTY IN MAIN-TAINING ADEQUATE SUPPLIES THROUGH ELECTION TIME.

9. ON EXPORT SIDE, MINISTER MAY BE CORRECT THAT REVAL- UATION WILL NOT HAVE MUCH AFFECT ON TEA AND RUBBER EXPORTS, AT LEAST IN SHORT-RUN. SINCE 1970, EXPORT PRICES OF THESE TWO MAJOR EXPORTS HAVE ALMOST DOUBLED IN TERMS OF DOLLARS AND ALMOST TRIPLED IN TERMS OF RUPEES. WHILE REVALUATION WILL TRIM ABOUT 20 PERCENT OFF INCREASED RUPEE EARNINGS THIS NOT LIKELY TO BE SERIOUS DISINCENTIVE TO PRODUCTION IN NEAR TERM. BUT WITH PRODUCTION ALREADY DOWN (8 PERCENT IN 1976 AND 6.3 PERCENT IN JANUARY 1977, CAMPARED WITH JANUARY 1976) DUE TO DROUGHT AND MISMANAGE- ENT, REDUCED EARNINGS WILL HARDLY HELP SITUATION. PRE- LIMINARY INDICATIONS ARE THAT RUBBER PRODUCTION ROSE SLIGHTLY IN 1976 AND 20 PERCENT CUT IN RUPEE EARNINGS WILL REDUCE EXPORT PRICE TO ABOUT RS 6.16 PER KILO WHICH IS STILL HIGHER THAN AVERAGE FOB PRICE PER KILO OF RS 5.70 RECORDED IN FEBRUARY 1976. IF DOMESTIC INFLATION (WHICH WAS ESTIMATED

AT 35-40 PERCENT IN 1976) IS TAKEN INTO ACCOUNT, HOWEVER,  
PRE-REVALUATION FOB PRICE HAD JUST ABOUT HELD ITS OWN IN  
REAL TERMS AND NEW PRICE REPRESENTS DECLINE IN REAL EARNINGS.  
WITH REGARD TO TOURIST EARNINGS, ONE OF SRI LANKA'S BIGGEST  
ATTRACTIVE IS LOW COST OF HOTELS AND FOOD FOR FOREIGNERS.  
TWENTY PERCENT INCREASE ON TOP OF RAPID DOMESTIC INFLATION  
MAY, DESPITE FINANCE MINISTER'S ASSERTION OTHERWISE,  
HAVE DETRIMENTAL EFFECT ON TOURISM.

10. ACCORDING TO GENERALLY ACCEPTED ECONOMIC THEORY,  
A REVALUATION (GIVEN THE RIGHT ELASTICITIES) SHOULD  
RESULT IN A DETERIORATION IN BALANCE OF PAYMENTS AND  
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NATIONAL INCOME WITH CONSEQUENT RISE IN UNEMPLOYMENT BASED  
ON LARGELY IMPRESSIONISTIC EVIDENCE, EMBASSY BELIEVES THAT  
MAY BE RESULT OF RUPEE REVALUATION.

11. REVALUATION FLIES IN FACE OF SRI LANKA'S DESIGNATION AS  
MOST SERIOUSLY AFFECTED COUNTRY WITH SERIOUS BALANCE OF PAYMENTS  
PROBLEMS. IT WILL BE INTERESTING TO SEE HOW MAJOR AID DONOR  
COUNTRIES REACT TO THIS MOVE. SRI LANKA HAS ALSO FINANCED LARGE  
PART OF ITS BALANCE OF PAYMENTS DEFICIT WITH COMMERCIAL CREDITS  
AND EMBASSY WOULD APPRECIATE RECEIVING ANY IMPRESSIONS DEPART-  
MENT MAY HAVE ON ATTITUDES OF MAJOR LENDERS TO SRI LANKA SUCH  
AS MANUFACTURERS TRUST, CHASE, ETC., AS WELL AS AID DONORS.  
REED

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## Message Attributes

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**Decaption Note:**  
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**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 22 May 2009  
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**TAGS:** EFIN, CE  
**To:** STATE  
**Type:** TE  
**vdkgvwkey:** odb://SAS/SAS.dbo.SAS\_Docs/988124b9-c288-dd11-92da-001cc4696bcc  
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